

Table of ContentsIndex to Financial Statements**Item 1A. Executive Officers**

Set forth below are the names and positions of our executive officers as of February 27, 2004, together with their ages and years of service with us.

<u>Name</u>	<u>Age</u>	<u>Position(s)</u>	<u>Served With the Company Since</u>
Bruce A. Williamson	44	President, Chief Executive Officer and Director	2002
Alec G. Dreyer	45	Executive Vice President, Generation	2000
Stephen A. Furbacher	56	Executive Vice President, Natural Gas Liquids	1996
Larry F. Altenbaumer	55	Executive Vice President, Regulated Energy Delivery	2000
Nick J. Caruso	57	Executive Vice President and Chief Financial Officer	2002
Carol F. Graebner	50	Executive Vice President and General Counsel	2003
R. Blake Young	45	Executive Vice President, Administration and Technology	1998

The executive officers named above will serve in such capacities until the next annual meeting of our Board of Directors, or until their respective successors have been duly elected and have been qualified, or until their earlier death, resignation, disqualification or removal from office.

Bruce A. Williamson has served as President, Chief Executive Officer and as a director of Dynegy since October 2002. Prior to joining Dynegy, Mr. Williamson served in various capacities with Duke Energy and its affiliates, most recently serving as President and Chief Executive Officer of Duke Energy Global Markets. In this capacity, he was responsible for all Duke Energy business units with global commodities and international business positions. Mr. Williamson joined PanEnergy Corporation in June 1995, which then merged with Duke Power in June 1997. Prior to the Duke-PanEnergy merger, he served as PanEnergy's Vice President of Finance. Before joining PanEnergy, he held positions of increasing responsibility at Shell Oil Company, advancing over a 14-year period to Assistant Treasurer.

Alec G. Dreyer has served as Executive Vice President of our generation segment since October 2002. Mr. Dreyer joined us in February 2000 upon consummation of the Illinova acquisition and has served various functions in our corporate finance department and power generation business. Prior to joining us, Mr. Dreyer served Illinova and its affiliates for 8 years, most recently as President of Illinova Generating Company and Senior Vice President of Illinova and Illinois Power. He was responsible for developing Illinova's spin off of its fossil-fueled generation fleet into an unregulated entity, which is now known as DMG.

Stephen A. Furbacher has served as Executive Vice President of our natural gas liquids segment since September 1996. He joined us in May 1996, just prior to our acquisition of Chevron's midstream business. Before joining us, he served as President of Warren Petroleum Company, the natural gas liquids division of Chevron U.S.A. He began his career with Chevron in August 1973 and served in positions of increasing responsibility before being named President of Warren Petroleum Company in July 1994.

Larry F. Altenbaumer has served as Executive Vice President of our regulated energy delivery segment since November 2002. In February 2004, Mr. Altenbaumer announced his retirement, effective April 1, 2004, from his service as our Executive Vice President and President of Illinois Power. He joined us in February 2000 upon consummation of the Illinova acquisition, at which time he served as Senior Vice President, Chief Financial Officer, Treasurer and Controller of Illinova and as Senior Vice President and Chief Financial Officer of Illinois Power. He joined Illinois Power in June 1970 and previously served Illinois Power in positions of increasing responsibility, including as Senior Vice President and Chief Financial Officer from June 1992 until September 1999.

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Nick J. Caruso has served as Executive Vice President and Chief Financial Officer since December 2002. Mr. Caruso is responsible for our internal audit, risk management, tax, treasury, accounting and finance functions. He was previously employed by Shell Oil Company from June 1969 to December 2001. He most recently served as that company's Vice President of Finance and Chief Financial Officer before retiring in December 2001. He was responsible for the controller's organization, treasury, insurance, auditing and retirement funds, interfacing with the board of directors on internal controls, and preparation of financial statements.

Carol F. Graebner has served as Executive Vice President and General Counsel since March 2003. Prior to joining us, Ms. Graebner was employed by Duke Energy International, where she served as senior vice president and general counsel and was responsible for providing all legal, regulatory and governmental affairs services for that company's international merchant energy business. Prior to joining Duke Energy International in November 1998, she served in various positions of increasing responsibility at Conoco Inc., advancing over a 16-year period to general counsel of Conoco Global Power, Inc.

R. Blake Young has served as Executive Vice President of Administration and Technology since October 2002. Formerly President of Global Technology, Mr. Young is responsible for strategic planning, corporate technology, corporate communications, investor relations, human resources, divestitures and corporate shared services. In addition, effective February 2004, Mr. Young became Executive Vice President and Chief Operating Officer of Illinois Power and will become President of Illinois Power on April 1, 2004. In these capacities he assumes overall responsibility for Illinois Power and the transition to Ameren during the regulatory approval process. Prior to joining us in October 1998, he worked for Campbell Soup Company where he was responsible for technology deployment across its U.S. grocery division and head of global business systems strategy. Mr. Young was previously employed by Tenneco Energy for approximately 13 years, where he served as Vice President and Chief Information Officer.

Item 2. Properties

We have included descriptions of the location and general character of our principal physical operating properties by segment in "Item 1. Business" beginning on page 1. Those descriptions are incorporated herein by this reference. Substantially all of our assets, including the physical operating properties we own, but excluding the assets of Illinois Power and DGC and their respective subsidiaries, are pledged as collateral with respect to the DHI amended credit facility. Please read Note 12—Debt beginning on page F-36 for further discussion of the amended credit facility.

Our principal executive office located in Houston, Texas is held under a lease that expires in December 2007. We also lease additional offices in the states of California, Florida, Georgia, Illinois, Massachusetts, and Texas; and the Canadian province of Ontario.

Item 3. Legal Proceedings

For a description of our material legal proceedings, please read Note 17—Commitments and Contingencies beginning on page F-51, which is incorporated herein by reference.

Item 4. Submission of Matters to a Vote of Security Holders

No matter was submitted to a vote of our security holders during the fourth quarter of 2003.

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Our Class A common stock, no par value per share, is listed and traded on the New York Stock Exchange under the ticker symbol "DYN." The number of stockholders of record of our Class A common stock as of February 23, 2004, based upon records of registered holders maintained by our transfer agent, was 22,308.

Our Class B common stock, no par value per share, is neither listed nor traded on any exchange. All of the shares of Class B common stock are owned by Chevron U.S.A.

The following table sets forth the high and low closing sales prices for the Class A common stock for each full quarterly period during the fiscal years ended December 31, 2003 and 2002, as reported on the New York Stock Exchange Composite Tape, and related dividends paid per share during these periods.

Summary of Dynegy's Common Stock Price and Dividend Payments

	<u>High</u>	<u>Low</u>	<u>Dividend</u>
2003:			
Fourth Quarter	\$ 4.35	\$ 3.45	\$ —
Third Quarter	4.65	2.85	—
Second Quarter	5.23	2.54	—
First Quarter	2.63	1.29	—
2002:			
Fourth Quarter	\$ 1.35	\$ 0.68	\$ —
Third Quarter	6.80	0.51	—
Second Quarter	30.09	6.08	0.075
First Quarter	32.00	21.25	0.075

Beginning with the third quarter 2002, our Board of Directors elected to cease payment of a common stock dividend. Payments of dividends for subsequent periods will be at the discretion of the Board of Directors, but we do not foresee reinstating the dividend in the near-term, particularly given the dividend restrictions contained in our financing agreements. Please read "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Dividends on Preferred and Common Stock" beginning on page 47 for further discussion of our dividend policy and the impact of these restrictions.

Shareholder Agreement

In June 1999, Chevron U.S.A., now a subsidiary of ChevronTexaco, entered into a shareholder agreement with us governing certain aspects of our relationship. The agreement was executed in February 2000, upon closing of the merger with Illinova, and reflected agreements negotiated between us and Chevron relating to Chevron's significant ownership interest in Dynegy. The agreement amended certain of the rights and obligations previously agreed between us and Chevron at the time of Chevron's initial investment in 1996. In August 2003, we entered into an amended and restated shareholder agreement with Chevron in connection with the consummation of the Series B Exchange. The material terms of this amended and restated shareholder agreement, which we refer to in this report as the shareholder agreement, are described below.

The shareholder agreement grants Chevron preemptive rights to acquire shares of our common stock in proportion to its then-existing interest in our equity value whenever we issue any equity securities, including securities issued pursuant to employee benefit plans. Chevron agreed to waive its preemptive rights in respect of the equity securities we issued in connection with the Series B Exchange and the Refinancing and up to \$250 million in equity securities we may issue in one or more future underwritten offerings.

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In addition, Chevron and its affiliates may acquire up to 40% of the total combined voting power of our outstanding voting securities without restriction in the shareholder agreement. Shares of Class B common stock issued to Chevron upon the mandatory conversion of Chevron's Class C convertible preferred stock are not counted when calculating this 40% threshold. We have agreed not to take any action that would cause Chevron's ownership to exceed this 40% threshold.

If Chevron or its affiliates wish to acquire more than 40% of the total combined voting power of our outstanding voting securities, the shareholder agreement requires Chevron to make an offer to acquire all of our outstanding voting securities for cash or freely tradable securities listed on a national securities exchange. Any offer by Chevron or its affiliates for all of our outstanding voting securities would be subject to the auction procedures outlined in the agreement.

Chevron's ownership of our Class B common stock entitles it to designate up to three members of our Board of Directors. The shareholder agreement prohibits Chevron from selling or transferring shares of Class B common stock except in the following transactions:

- a widely-dispersed public offering;
- an unsolicited sale to a third party, provided that we or our designee are given the opportunity to purchase the shares proposed to be sold; or
- a solicited sale to an acceptable third party, provided that if we advise Chevron that the sale to a third party is not acceptable, we must purchase all of the offered shares for cash at a purchase price equal to 105% of the third party offer.

Upon the sale or transfer to any person other than an affiliate of Chevron, the shares of Class B common stock automatically convert into shares of Class A common stock.

The shareholder agreement further provides that we may require Chevron and its affiliates to sell all of the shares of Class B common stock under specified circumstances. These rights are triggered if Chevron or its Board designees block—which they are entitled to do under our Bylaws—any of the following transactions two times in any 24-month period or three times over any period of time:

- the issuance of new shares of stock where the aggregate consideration to be received exceeds the greater of \$1 billion or one-quarter of our total market capitalization;
- any disposition of all or substantially all of our liquids business while substantial agreements between Chevron and us exist (except for a contribution of such liquids business to an entity in which we have a majority direct or indirect interest);
- any merger, consolidation, joint venture, liquidation, dissolution, bankruptcy, acquisition of stock or assets, or issuance of common or preferred stock, any of which would result in payment or receipt of consideration having a fair market value exceeding the greater of \$1 billion or one-quarter of our total market capitalization; or
- any other material transaction or series of related transactions which would result in the payment or receipt of consideration having a fair market value exceeding the greater of \$1 billion or one-quarter of our total market capitalization.

However, upon occurrence of one of these triggering events and in lieu of selling Class B common stock, Chevron may elect to retain the shares of Class B common stock but forfeit its right and the right of its Board designees to block the subject transaction. A block consists of a vote against a proposed transaction by either (a) all of Chevron's representatives on the Board of Directors present at the meeting where the vote is taken (if the transaction would otherwise be approved by the Board of Directors) or (b) any of the Class B common stock held by Chevron and its affiliates if the transaction otherwise would be approved by at least two-thirds of all other shares entitled to vote on the transaction, excluding shares held by our management, directors or subsidiaries.

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The shareholder agreement also prohibits us from taking the following actions:

- issuing any shares of Class B common stock to any person other than Chevron and its affiliates;
- adopting a shareholder rights plan, "poison pill" or similar device that prevents Chevron from exercising its rights to acquire shares of common stock or from disposing of its shares when required by us; and
- acquiring, owning or operating a nuclear power facility, other than being a passive investor in a publicly-traded company that owns a nuclear facility.

Generally, the provisions of the shareholder agreement terminate on the date Chevron and its affiliates cease to own shares representing at least 15% of our outstanding voting power. At such time all of the shares of Class B common stock held by Chevron would convert to shares of Class A common stock.

Sales of Unregistered Securities

December 2001 Equity Purchases. In December 2001, 10 members of our senior management purchased approximately 1,260,000 shares of Class A common stock from us in a private placement pursuant to Section 4(2) of the Securities Act of 1933, as amended. These officers received loans totaling approximately \$25 million from us to purchase the common stock at a price of \$19.75 per share, the same price as the net proceeds per share received by us from a concurrent public offering. The loans bear interest at 3.25% per annum and are full recourse to the borrowers. Such loans are accounted for as subscriptions receivable within stockholders' equity on the consolidated balance sheets. We recognized compensation expense in 2001 of approximately \$1.2 million related to the shares purchased by these officers. This amount, which was recorded as general and administrative expense, is derived from the \$1.00 per share discount these officers received based on the initial public offering price of \$20.75 per share. For further discussion, please see Note 13—Related Party Transactions—December 2001 Equity Purchases beginning on page F-45.

Other Unregistered Common Stock Sales. In March 2001, we sold nearly 1.2 million shares of Class B common stock to Chevron at \$34.93 per share in a private transaction under Section 4(2) of the Securities Act pursuant to the exercise of its pre-emptive rights under the shareholder agreement. The proceeds from this transaction were approximately \$41 million.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table sets forth certain information as of December 31, 2003 as it relates to our equity compensation plans.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	13,209,335	\$ 18.47	10,582,078
Equity compensation plans not approved by security holders (1)	4,418,101	\$ 19.25	1,486,974
Total	17,627,436	\$ 18.66	12,069,052

- (1) The plans that were not approved by our security holders are as follows: Extant Plan, Dynegy 2001 Non-Executive Stock Incentive Plan and Dynegy UK Plan. Please read Note 19—Capital Stock—Stock Options beginning on page F-66 for a brief description of our equity compensation plans, including these plans.

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The selected financial information presented below was derived from, and is qualified by reference to, our Consolidated Financial Statements, including the notes thereto, contained elsewhere herein. The selected financial information should be read in conjunction with the Consolidated Financial Statements and related notes and Management's Discussion and Analysis of Financial Condition and Results of Operations. Earnings (loss) per share ("EPS"), shares outstanding for EPS calculation and cash dividends per common share have been adjusted for a two-for-one stock split on August 22, 2000 and, for all periods prior to February 1, 2000, the 0.69-to-one exchange ratio in the Illinova acquisition.

Dynegy's Selected Financial Data

	Year Ended December 31,				
	2003	2002	2001	2000	1999
	(in millions, except per share data)				
Statement of Operations Data (1):					
Revenues	\$5,787	\$ 5,326	\$ 9,124	\$ 9,715	\$4,821
General and administrative expenses	(366)	(325)	(420)	(312)	(208)
Depreciation and amortization expense	(454)	(466)	(456)	(390)	(115)
Asset impairment, abandonment and other charges	(7)	(190)	—	—	—
Goodwill impairment	(242)	(897)	—	—	—
Operating income (loss)	(307)	(1,141)	967	766	184
Interest expense	(509)	(297)	(255)	(247)	(77)
Income tax expense (benefit)	(198)	(276)	357	234	41
Net income (loss) from continuing operations	(474)	(1,349)	486	409	93
Income (loss) on discontinued operations (3)	(19)	(1,154)	(82)	27	44
Cumulative effect of change in accounting principles	40	(234)	2	—	—
Net income (loss)	\$ (453)	\$ (2,737)	\$ 406	\$ 436	\$ 137
Net income (loss) available to common stockholders	560	(3,067)	364	401	137
Earnings (loss) per share from continuing operations	\$ 1.30	\$ (4.59)	\$ 1.31	\$ 1.18	\$ 0.41
Net income (loss) per share	1.35	(8.38)	1.07	1.27	0.60
Shares outstanding for diluted EPS calculation	423	370	340	315	230
Cash dividends per common share	\$ —	\$ 0.15	\$ 0.30	\$ 0.25	\$ 0.04
Cash Flow Data:					
Cash flows from operating activities	\$ 876	\$ (25)	\$ 550	\$ 420	\$ 40
Cash flows from investing activities	(266)	677	(3,828)	(1,539)	(391)
Cash flows from financing activities	(900)	(44)	3,450	1,131	399
Cash dividends or distributions to partners, net	—	(55)	(98)	(112)	(8)
Capital expenditures, acquisitions and investments	(338)	(981)	(4,687)	(2,415)	(521)

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	December 31,				
	2003	2002	2001	2000	1999
	(in millions)				
Balance Sheet Data (2):					
Current assets	\$ 3,030	\$ 7,586	\$ 8,956	\$10,827	\$2,658
Current liabilities	2,576	6,748	8,538	10,286	2,467
Property, plant and equipment, net	8,396	8,458	9,269	7,148	2,155
Total assets	13,293	20,099	25,236	22,729	6,516
Long-term debt (excluding current portion)	5,893	5,454	5,016	3,754	1,372
Notes payable and current portion of long-term debt	331	861	458	118	192
Non-recourse debt	—	—	—	—	35
Serial preferred securities of a subsidiary	11	11	46	46	—
Subordinated debentures	—	200	200	300	200
Series B Preferred Stock (4)	—	1,212	882	—	—
Series C convertible preferred stock	400	—	—	—	—
Minority interest (5)	121	146	1,040	1,022	—
Capital leases not already included in long-term debt	—	15	29	15	—
Total equity	2,045	2,087	4,937	3,441	1,240

- (1) The following acquisitions were accounted for in accordance with the purchase method of accounting and the results of operations attributable to the acquired businesses are included in our financial statements and operating statistics beginning on the acquisitions' effective date for accounting purposes:
- Northern Natural—February 1, 2002;
 - BGSL—December 1, 2001;
 - iaxis—March 1, 2001;
 - Extant—October 1, 2000; and
 - Illinova—January 1, 2000.
- (2) The Northern Natural, BGSL, iaxis, Extant and Illinova acquisitions were each accounted for under the purchase method of accounting. Accordingly, the purchase price was allocated to the assets acquired and liabilities assumed based on their estimated fair values as of the effective dates of each transaction. See note (1) above for respective effective dates.
- (3) Discontinued operations includes the results of operations from the following businesses:
- Northern Natural (sold third quarter 2002);
 - U.K. Storage—Hornsea facility (sold fourth quarter 2002) and Rough facility (sold fourth quarter 2002);
 - DGC (portions sold in fourth quarter 2002 and first and second quarters 2003);
 - Global Liquids (sold fourth quarter 2002); and
 - U.K. CRM (substantially liquidated in first quarter 2003).
- (4) The 2002 amount equals the \$1.5 billion in proceeds related to the Series B Preferred Stock less the \$660 million implied dividend recognized in connection with the beneficial conversion option plus \$372 million in accretion of the implied dividend through December 31, 2002. The 2001 amount equals the \$1.5 billion in proceeds less the \$660 million implied dividend plus \$42 million in accretion of the implied dividend through December 31, 2001. Please read Note 15—Redeemable Preferred Securities—Series B Preferred Stock beginning on page F-48 for further discussion.
- (5) The 2001 and 2000 amounts include amounts relating to the Black Thunder transaction discussed in Note 12—Debt—Black Thunder Secured Financing beginning on page F-40.

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The following discussion should be read together with the audited consolidated financial statements and the notes thereto included in this report.

OVERVIEW

We are a holding company and conduct substantially all of our business operations through our subsidiaries. Our current business operations are focused primarily in three areas of the energy industry: power generation; natural gas liquids; and regulated energy delivery. Because of the diversity among their respective operations, we report the results of each business as a separate segment in our consolidated financial statements. We also separately report the results of our customer risk management business, which primarily consists of our four remaining power tolling arrangements and related gas transportation contracts, as well as legacy gas and power trading positions. Our consolidated financial results also reflect corporate-level expenses such as general and administrative, interest and depreciation and amortization, but because of their nature, these items are not reported as a separate segment.

Following is a brief discussion of each of our four business segments, including a list of key factors that have affected, and are expected to continue to affect, their respective earnings and cash flows. We also present a brief discussion of our corporate-level expenses. This "Overview" section concludes with a summary of our current liquidity position and items that could impact our liquidity position in 2004 and beyond. Please note that this "Overview" section is merely a summary and should be read together with the remainder of Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as the audited consolidated financial statements, including the notes thereto, and the other information included in this report.

Power Generation. Our power generation business owns or leases more than 12,700 MWs of net generating capacity located in six regions of the United States. Our power generating fleet is diversified by facility type (base load, intermediate and peaking), fuel source and geographic location. We generate earnings and cash flows in this business through sales of energy and capacity.

The primary factors impacting our power generation earnings and cash flows are the prices for power and, to a lesser extent, natural gas, which in turn are largely driven by supply and demand. Demand for power can vary regionally due to, among other things, weather and general economic conditions. Power supplies similarly vary by region and are impacted significantly by available generating capacity, transmission capacity and federal and state regulation. We also are impacted by the relationship between prices for power and natural gas, commonly referred to as the "spark spread," and its impact on the cost of generating electricity. However, we believe that our significant coal-fired and fuel oil generating facilities partially mitigate our sensitivity to changes in the spark spread, in that coal and fuel oil prices are relatively stable and insensitive to changes in gas prices, and position us for potential increases in earnings and cash flows in an environment where both power and gas prices increase. Please read "—Liquidity and Capital Resources—Internal Liquidity Sources—Cash Flows from Operations" beginning on page 47 for a discussion of our views on the current pricing environment and its anticipated long-term recovery.

Other factors that have impacted, and are expected to continue to impact, earnings and cash flows for this business include:

- our ability to control our capital expenditures, which primarily are limited to maintenance, safety, environmental and reliability projects, and other costs through disciplined management and safe, efficient operations;
- our ability to optimize our assets through forward hedging activities and similar transactions, which is affected by general market liquidity and the need to satisfy counterparties' collateral requirements given our non-investment grade credit ratings; and

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- our ability to enter into new sales contracts and to renew our existing contracts, particularly the CDWR and Illinois Power power purchase agreements that are scheduled to expire at the end of 2004. In connection with our recently announced agreement to sell Illinois Power to Ameren, we agreed, conditioned upon the closing of the sale, to sell 2,800 MWs of capacity and up to 11.5 million MWh of energy to Illinois Power at fixed prices for two years beginning in January 2005. The closing of the sale to Ameren, which is expected by the end of 2004, is subject to receipt of required regulatory approvals and other closing conditions. Please read “—Results of Operations—Segment Discussion—2004 Outlook—REG Outlook” beginning on page 65 and Note 23—Subsequent Event beginning on page F-77 for further discussion.

Natural Gas Liquids. Our natural gas liquids business owns natural gas gathering and processing, or upstream, assets in key producing areas of Louisiana, New Mexico and Texas. This business also owns integrated downstream assets used to fractionate, store, terminal, transport, distribute and market natural gas liquids. These downstream assets generally are connected to and supplied by our and third parties’ upstream assets and are located in Mont Belvieu, Texas, the hub of the U.S. natural gas liquids business, and West Louisiana.

We generate earnings and cash flows in the upstream business by selling our gathering, processing and treating services to producers. We generate earnings and cash flows in our downstream business through sales of our fractionation, storage, transportation and terminalling services and sales of natural gas liquids through our marketing operations.

The earnings and cash flows that we generate in this business are sensitive to natural gas and natural gas liquids prices and the relationship between the two, commonly referred to as the “frac spread.” In our upstream business, we continued the restructuring of our contract portfolio in 2003. As a result, our current contract mix has reduced our exposure to frac spread risk. Please read Item 1. Business—Segment Discussion—Natural Gas Liquids—Upstream Business beginning on page 7 for a detailed discussion of our current upstream contract mix.

In addition to commodity prices, other factors that have impacted, and are expected to continue to impact, the earnings and cash flows for this business include:

- our ability to control our capital expenditures, which primarily are limited to maintenance, safety and reliability projects, and other costs through disciplined management and safe, efficient operations;
- reduced market liquidity and our obligation to post collateral to counterparties because of our non-investment grade credit ratings, which limit our ability to contract forward physically for some of our natural gas liquids products;
- producer drilling activity, which is significantly affected by commodity prices;
- a low frac spread environment and the resulting reduction in volumes available for fractionation, distribution and marketing;
- the petrochemical industry’s need for and utilization of our natural gas liquids feedstocks and related natural gas liquids facilities;
- our ability to manage our natural gas liquids inventories efficiently; and
- our ability to meet customer demands for timely delivery and transportation.

Regulated Energy Delivery. Our regulated energy delivery segment is currently comprised of our Illinois Power subsidiary. From February 2002 through July 2002, this segment, formerly called the Transmission and Distribution segment, also included the results of Northern Natural. Northern Natural’s results for this period are reflected in Discontinued Operations in our consolidated statements of operations.

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Illinois Power is a regulated utility that serves more than 590,000 electricity customers and nearly 415,000 natural gas customers in portions of northern, central and southern Illinois. We generate earnings and cash flows in this business through sales of electric and gas service to residential, commercial and industrial customers.

The earnings and cash flows generated by this business are primarily driven by the volumes of electricity and natural gas that we sell and deliver. In terms of costs, retail electric rates are frozen through 2006, and gas costs are passed through to customers. The primary factors impacting sales volumes include:

- weather and its effect on demand for our services, particularly with respect to residential electric customers;
- the number of customers that choose another retail electric provider under the Illinois Customer Choice Law;
- our ability to control our capital expenditures, which primarily are limited to maintenance, safety and reliability projects, and other costs through disciplined management and safe, efficient operations; and
- general economic conditions and the resulting effect on demand for our services, particularly with respect to commercial and industrial customers.

We recently entered into an agreement to sell Illinois Power and our 20% interest in the Joppa power generation facility to Ameren for \$2.3 billion. The transaction is expected to close by the end of 2004, subject to the receipt of required regulatory approvals and other closing conditions. Please read Note 23—Subsequent Event beginning on page F -77 for further discussion.

Customer Risk Management. Our customer risk management business primarily consists of our four remaining power tolling arrangements and related gas transportation contracts, as well as our legacy gas and power trading positions. We have significant, long-term fixed obligations associated with our tolling and gas transportation arrangements, which obligations substantially exceed the earnings and cash flows we expect to generate in connection with these arrangements. Our ability to mitigate partially the negative impact of these arrangements on our earnings and cash flows depends on the price of power and the spark spread in the regions where the tolling plants are located, as well as our ability to re-market the related capacity under the transportation arrangements. It also will be significantly impacted by our ability to restructure or terminate one or more of our power tolling arrangements, which we expect would require a significant cash payment.

Regarding our legacy gas and power trading positions, we have substantially reduced the size of our portfolio relative to when we were primarily a marketing and trading company. Please read Item 1. Business—Segment Discussion—Customer Risk Management beginning on page 18 for further discussion.

Corporate and Other. Beginning January 1, 2003, Corporate and other includes corporate-level items that were previously allocated to our operating segments. Significant items impacting future earnings and cash flows include:

- interest expense, which increased in 2003 as a result of our refinancing and restructuring activities and will continue to reflect our non-investment grade credit ratings;
- general and administrative costs, with respect to which we have implemented a number of initiatives expected to yield savings beginning in 2004; general and administrative costs also will be impacted by, among other things, (i) any future corporate-level litigation reserves or settlements and (ii) potential funding requirements under our pension plans; and
- income taxes, with respect to which we currently only pay minimal state and foreign income taxes; income taxes will also be impacted by our ability to realize our significant deferred tax assets, including loss carryforwards.

In addition, dividends associated with our outstanding preferred stock will continue to affect our earnings available to our common shareholders.

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Liquidity. As of February 23, 2004, we had cash on hand of \$397 million and available borrowing capacity of \$866 million, for total liquidity of nearly \$1.3 billion. During 2003, we substantially reduced our debt and other obligations while maintaining liquidity between \$1.4 billion and \$1.7 billion. Our ability to maintain our liquidity position in the future will depend on a number of factors, including our ability to consummate the Illinois Power sale to Ameren and, over the longer term, to generate cash flows from our asset-based energy businesses in relation to our substantial debt obligations and ongoing operating requirements.

For the next 12 months, assuming continuation of the current commodity pricing environment, we expect that our operating cash flows will be insufficient to satisfy our capital expenditures, debt maturities, increased interest expenses and operating commitments. When combined with our cash on hand, proceeds from anticipated asset sales and capacity under our \$1.1 billion revolving credit facility, however, we believe we have sufficient capital resources to satisfy these obligations during this period. To further our deleveraging efforts, we also intend to explore other capital-raising activities, including potential public or private equity issuances. In addition, we will seek to renew or replace our \$1.1 billion revolving credit facility, which is scheduled to mature on February 15, 2005. Our liquidity position will be materially adversely affected if we are unable to renew or replace this facility, with respect to which our ability to borrow and/or issue letters of credit could become increasingly important, on or before its scheduled maturity.

Over the longer term, we believe that power prices will improve in some or all of the regions in which we operate as the supply-demand imbalance for power decreases. Much of the restructuring work that we did during 2003 extended a substantial portion of our debt maturities from 2005-2006 to 2008 and beyond, positioning us to benefit from earnings and growth opportunities associated with this expected recovery in the U.S. power markets. Conversely, although depressed frac spreads have negatively impacted our NGL segment's downstream operations, our upstream business is currently operating in a relatively favorable pricing environment. Our future financial condition and results of operations will be materially affected if the U.S. power markets fail to recover in accordance with our expectations or if we experience significant pricing deterioration in our NGL segment.

LIQUIDITY AND CAPITAL RESOURCES

Debt Maturities

During 2003, we consummated a series of refinancing and restructuring transactions comprised of the following:

- Restructuring of \$1.66 billion in credit facilities prior to their scheduled maturities, in connection with which we granted security interests in a substantial portion of the available assets and stock of our direct and indirect subsidiaries, excluding Illinois Power;
- Issuance by DHI of \$1.75 billion of senior notes at a weighted average interest rate of 9.71% and a weighted average yield to maturity of 9.65%, which notes are secured on a second priority basis by substantially the same collateral that secures the obligations under DHI's restructured credit facility;
- Issuance by Dynegy of \$225 million of convertible subordinated debentures at an interest rate of 4.75%, which debentures are convertible into shares of our Class A common stock at \$4.1210 per share, subject to certain adjustments, and guaranteed on a senior unsecured basis by DHI;
- The purchase of approximately \$282 million of DHI's \$300 million 8.125% Senior Notes due 2005, virtually all of DHI's \$150 million 6 3/4% Senior Notes due 2005 and approximately \$177 million of DHI's \$200 million 7.450% Senior Notes due 2006; and
- Restructuring of the \$1.5 billion in Series B Mandatorily Convertible Redeemable Preferred Stock previously held by a ChevronTexaco subsidiary, which we refer to as the Series B Preferred Stock. Under this restructuring, which we refer to as the Series B Exchange, the Series B Preferred Stock was exchanged for \$225 million in cash, \$225 million principal amount of our Junior Unsecured

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Subordinated Notes due 2016, which we refer to as the Junior Notes, and 8 million shares of our Series C Mandatorily Redeemable Convertible Preferred Stock due 2033 (liquidation preference \$50 per share), which we refer to as the Series C preferred stock. The Series C preferred stock generally is convertible into shares of our Class B common stock at \$5.78 per share, subject to shareholder approval, which approval we intend to solicit at our 2004 annual shareholder meeting.

We used the net cash proceeds from these transactions, together with approximately \$300 million of cash on hand and additional funds received in the form of returned prepayments from ChevronTexaco under the Series B Exchange, to make the \$225 million Series B Exchange payment, to purchase the DHI senior notes and to otherwise reduce our 2005 debt maturities as follows:

- Prepay in full the \$200 million Term A loan outstanding under DHI's restructured credit facility;
- Prepay in full the \$360 million Term B loan outstanding under DHI's restructured credit facility;
- Prepay in full the \$696 million of debt outstanding under the Black Thunder secured financing; and
- Prepay in full the \$170 million capital lease obligation associated with our CoGen Lyondell power generating facility.

For a more complete description of these transactions, including the increasing interest rate and conversion features of the securities issued in connection with the Series B Exchange, please read Note 11—Refinancing and Restructuring Transactions beginning on page F-34.

As a result of these transactions, we extended a substantial portion of our 2005-2006 maturities to 2008 and beyond. Our aggregate maturities for long-term debt are as follows:

<u>Period</u>	<u>Total</u>	<u>Illinois Power (1)</u>	<u>Total Less Illinois Power (1)</u>
		(in millions)	
2004 (2)	\$ 331	\$ 157	\$ 174
2005	258	156	102
2006	130	86	44
2007	270	86	184
2008	311	86	225
Thereafter	4,924	1,366	3,558

- (1) If the Ameren transaction closes as expected before the end of 2004, Ameren will assume Illinois Power's then outstanding indebtedness. Please read Note 12—Debt beginning on page F-36 for further discussion of our outstanding debt.
- (2) Included in Illinois Power's 2004 maturities of \$157 million is \$71 million related to the Tilton capital lease. In October 1999, Illinois Power entered into a sublease with DMG pursuant to which DMG is obligated to make all payments under the lease.

One important near-term maturity that remains is our \$1.1 billion revolving credit facility, which is scheduled to mature on February 15, 2005. While we currently have no drawn amounts under this facility, our ability to borrow and/or issue letters of credit under a revolving credit facility could become increasingly important, particularly if we are unable to generate operating cash flows relative to our substantial debt obligations and ongoing operating requirements or to realize the asset sale proceeds we anticipate. We currently intend to renew or replace this facility during 2004, although we cannot guarantee that we will be successful.

While our restructuring and refinancing transactions have extended our significant debt maturities, they also resulted in significantly increased interest expenses, as further described under "—Results of Operations – Interest Expense" beginning on page 63. We also are subject to the more restrictive covenants that are contained

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in the related transaction agreements. Specifically, among other limitations, these covenants limit our ability to receive payments from DHI for the purpose of paying dividends on our common stock and otherwise, limit DHI's ability to incur additional indebtedness other than for refinancing purposes and require that a significant portion of proceeds from specified asset sales and equity issuances be used to pay down outstanding indebtedness. For example, upon closing of the agreed sale of Illinois Power to Ameren, we must use 75% of the net cash proceeds to repay the Junior Notes. We are required to use 25% of the net cash proceeds of the sale to reduce permanently or cash collateralize the commitments under the facility, subject to certain exceptions, to the extent the Junior Notes are repaid up to \$100 million. If the Junior Notes are not outstanding, 100% of the net cash proceeds from asset sales are required to be used, subject to certain exceptions, to reduce the commitments under the revolver. While we are currently in compliance with these restrictive covenants, our future financial condition and results of operations could be significantly affected by our ability to execute our business and financial strategies within the confines of these restrictive covenants.

The following table depicts our consolidated third-party debt obligations, including the principle-like maturities associated with the DNE leveraged lease, and the extent to which they are secured as of December 31, 2003 and 2002:

	December 31, 2003	December 31, 2002
	(in millions)	
First Secured Obligations		
Dynegy Holdings Inc.	\$ 1,127	\$ 2,440
Dynegy Inc.	—	360
Illinois Power (1)	1,967	2,092
Total First Secured Obligations	3,094	4,892
Second Secured Obligations	1,750	—
Unsecured Obligations	2,160	2,266
Subtotal	7,004	7,158
Preferred Obligations	411	1,711
Total Obligations	\$ 7,415	\$ 8,869
Less: DNE Lease Financing	(758)	(746)
Less: Preferred Obligations	(411)	(1,711)
Other (2)	(22)	(97)
Total Notes Payable and Long-term Debt	\$ 6,224	\$ 6,315

- (1) Ameren will assume Illinois Power's debt obligations upon closing of our agreed sale of Illinois Power, which is anticipated to occur before the end of 2004, subject to receipt of required regulatory approvals and other closing conditions. Please read Note 23—Subsequent Event beginning on page F-77 for further discussion.
- (2) Consists of net discounts on debt (totaling \$12 million and \$16 million at December 31, 2003 and December 31, 2002, respectively) and the \$10 million difference between the carrying value of the Tilton capital lease and the purchase obligation of \$81 million at December 31, 2003. At December 31, 2002, the Tilton lease was off-balance sheet as it was accounted for as an operating lease.

Collateral Postings

We have substantially reduced our collateral postings since the end of 2002. As detailed in the table below, total collateral postings are down by approximately \$704 million as of February 23, 2004. The reduction is particularly pronounced in our CRM segment, which we commenced exiting in October 2002. Our collateral postings are down in that segment by more than \$634 million since year-end 2002 and by more than \$800 million from their peak at September 30, 2002.

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The following table summarizes our consolidated collateral postings to third parties by operating division at February 23, 2004, December 31, 2003 and December 31, 2002:

	February 23, 2004	December 31, 2003	December 31, 2002
		(in millions)	
GEN	\$ 146	\$ 136	\$ 168
CRM	172	121	806
NGL	144	179	166
REG	42	38	28
Other	8	8	48
Total	\$ 512	\$ 482	\$ 1,216

As described in Note 12—Debt—DHI Credit Facility beginning on page F-37, we incur a 0.15% fronting fee upon the issuance of letters of credit under our restructured credit facility. A letter of credit fee is also payable on the undrawn amount of each letter of credit outstanding at a percentage per annum equal to 4.75% of such undrawn amount. To reduce these fees, we have used, and expect to continue to use, cash on hand, as opposed to letters of credit, to satisfy our future collateral obligations where practicable. Our ability to continue this strategy depends to a large extent on the creditworthiness of our counterparties and the availability of cash on hand.

Going forward, we expect counterparties' collateral demands to reflect changes in commodity prices, including seasonal changes in weather-related demand, as well as their view of our creditworthiness. We believe that we have sufficient capital resources to satisfy counterparties' collateral demands, including those for which no collateral is currently posted, for at least the next 12 months. Over the longer term, we expect to achieve incremental reductions associated with the completion of our exit from the customer risk management business. Please see "—Results of Operations—2004 Outlook—CRM Outlook" beginning on page 66 for a discussion of the expected collateral roll-off from this business.

Disclosure of Contractual Obligations and Contingent Financial Commitments

We incur contractual obligations and financial commitments in the normal course of our operations and financing activities. Contractual obligations include future cash payments required under existing contracts, such as debt and lease agreements. These obligations may result from both general financing activities and from commercial arrangements that are directly supported by related operating activities. Financial commitments represent contingent obligations, such as financial guarantees, that become payable only if specified events occur. Details on these obligations are set forth below.

Contractual Obligations

The following table summarizes our contractual obligations as of December 31, 2003. Cash obligations reflected are not discounted and do not include related interest, accretion or dividends.

	Payments Due by Period						
	Total	2004	2005	2006	2007	2008	Thereafter
				(in millions)			
Long-Term Debt (including Current Portion)	\$ 6,153	\$260	\$258	\$130	\$270	\$311	\$ 4,924
Capital Leases	81	81	—	—	—	—	—
Redeemable Preferred Securities	411	—	—	—	—	—	411
Operating Leases	1,588	81	81	81	127	147	1,071
Unconditional Purchase Obligations	53	53	—	—	—	—	—
Capacity Payments	2,852	259	243	231	232	232	1,655
Conditional Purchase Obligations	766	222	158	207	127	38	14
Pension Funding Obligations	111	8	57	46	—	—	—
Other Long-Term Obligations	7	6	1	—	—	—	—

Total Contractual Obligations	<u>\$12,022</u>	<u>\$970</u>	<u>\$798</u>	<u>\$695</u>	<u>\$756</u>	<u>\$728</u>	<u>\$ 8,075</u>
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Long-Term Debt (including Current Portion). Total amounts of Long-Term Debt (including Current Portion) are included in the December 31, 2003 Consolidated Balance Sheet. For additional explanation, please read Note 12—Debt beginning on page F-36.

Additionally, we have entered into various joint ventures principally to share risk or optimize existing commercial relationships. These joint ventures maintain independent capital structures and, where necessary, have financed their operations on a non-recourse basis to us. Please read Note 9—Unconsolidated Investments beginning on page F-29 for further discussion of these joint ventures.

Capital Leases. Capital leases consist of our Tilton capital lease obligation. Of the \$81 million obligation above, \$71 million is included in the December 31, 2003 Consolidated Balance Sheet as a component of Notes Payable and Current Portion of Long-Term Debt. The \$10 million difference will be accreted over the remaining term of the capital lease through a charge to interest expense with a corresponding increase to short-term debt. We began reflecting the Tilton facility and the related debt in our consolidated balance sheets in September 2003 as a result of our delivery of a notice of our intent to purchase the related turbines upon the lease expiration in September 2004. For additional explanation, please read Note 12—Debt—Tilton Capital Lease beginning on page F-41.

Redeemable Preferred Securities. Total amounts of Redeemable Preferred Securities are included in the December 31, 2003 Consolidated Balance Sheet. For additional explanation, please read Note 15—Redeemable Preferred Securities beginning on page F-48.

Operating Leases. Operating leases includes the minimum lease payment obligations associated with our DNE leveraged lease. For additional information, please read “—Liquidity and Capital Resources—Off-Balance Sheet Arrangements—DNE Leveraged Lease” beginning on page 44. Amounts also include minimum lease payment obligations associated with office and office equipment leases.

Unconditional Purchase Obligations. Amounts include natural gas and power purchase agreements. For additional information, please read Note 17—Commitments and Contingencies—Other Commitments and Contingencies—Purchase Obligations beginning on page F-61.

Capacity Payments. Capacity payments include future payments aggregating \$2.3 billion under our four remaining power tolling arrangements, as further described in Item 1. Business—Segment Discussion—Customer Risk Management beginning on page 18. This amount includes the fixed payments associated with a derivative instrument related to the Sithe tolling arrangement, which is reflected at its fair value on our Consolidated Balance Sheet in Risk-Management Liabilities, as well as amounts relating to contracts that are accounted for on an accrual basis. At December 31, 2003, approximately \$325 million of fixed payments have been reflected in the fair value of the Sithe derivative instrument. We are exploring opportunities to renegotiate or terminate one or more of these arrangements on terms we consider economical. Please read “—Results of Operations—2004 Outlook—CRM Outlook” beginning on page 66 for further discussion of the anticipated effects of these arrangements on our future results of operations.

In addition, capacity payments include fixed obligations associated with transmission, transportation and storage arrangements totaling approximately \$573 million.

Conditional Purchase Obligations. Amounts include our obligations as of December 31, 2003 to purchase 14 gas-fired turbines. The purchase orders include milestone requirements by the manufacturer and provide us with the ability to cancel each discrete purchase order commitment in exchange for a fee, which escalates over time. The \$479 million included herein assume all 14 turbines will be purchased. In February 2004, we terminated our conditional purchase obligation related to these gas fired turbines as part of a comprehensive settlement agreement with the manufacturer. No cash, other than \$11 million previously paid to the manufacturer as a deposit, is expected to be provided as consideration for the termination.

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Amounts also include \$205 million related to Illinois Power's long-term power purchase agreement with AmerGen. The agreement was entered into in connection with the sale of Illinois Power's former Clinton nuclear generation facility in December 1999. Illinois Power is obligated to purchase a predetermined percentage of Clinton's electricity output through 2004 at fixed prices that exceed current and projected wholesale prices. At the time of the sale of the nuclear generation facility, a liability was recorded related to the above-market portion of this purchase agreement, which is being amortized through 2004, based on the expected energy to be purchased from AmerGen.

Amounts also include \$136 million related to our co-sourcing agreement with Accenture Ltd. This 10-year agreement may be cancelled after two years upon the payment of a termination fee.

Pension Funding Obligations. Amounts include estimated defined benefit pension funding obligations for 2004 (\$8 million), 2005 (\$57 million) and 2006 (\$46 million). Although we expect to incur significant funding obligations subsequent to 2006, such amounts have not been included in this table because our estimates are imprecise. Under the terms of the sale of Illinois Power to Ameren, we will be required to accelerate certain of our 2005 cash funding requirements at closing of the sale.

Other Long-Term Obligations. Amounts include decommissioning costs related to Illinois Power's sale of its Clinton nuclear facility in 1999 and decontamination and decommissioning charges associated with Illinois Power's use of a facility that enriched uranium for the Clinton Power Station.

Contingent Financial Obligations

The following table provides a summary of our contingent financial obligations as of December 31, 2003 on an undiscounted basis. These obligations represent contingent obligations that may require a payment of cash upon the occurrence of specified events.

	Expiration by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
			(in millions)		
Letters of Credit (1)	\$188	\$ 188	\$ —	\$ —	\$ —
Surety Bonds (2)(4)	80	80	—	—	—
Guarantees (3)	131	13	26	26	66
Total Financial Commitments	\$399	\$ 281	\$ 26	\$ 26	\$ 66

(1) Amounts include outstanding letters of credit.

(2) Surety bonds are generally on a rolling 12-month basis.

(3) Amounts include two charter party agreements relating to VLGCs previously utilized in our global liquids business sub-chartered to a wholly owned subsidiary of Transammonia Inc. The terms of the sub-charters are identical to the terms of the original charter party agreements. We are currently in negotiations with the owners of the VLGCs and their lenders to obtain a novation/release of the two charter party agreements and a release of our guarantees.

(4) \$45 million of the surety bonds were supported by collateral.

Off-Balance Sheet Arrangements

In September 2003, we delivered notice of our intent to exercise our option to purchase the Tilton assets upon the expiration of the operating lease in September 2004. As a result of this action, we began accounting for the related lease obligation, which we formerly reported as an off-balance sheet arrangement, as a capital lease. Following is a discussion of our remaining off-balance sheet arrangement.

DNE Leveraged Lease. As described in Item 1. Business—Segment Discussion—Power Generation—Northeast region—Northeast Power Coordinating Council (NPCC) beginning on page 5, we established our

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presence in the Northeast region by acquiring the DNE power generating facilities in January 2001 for \$950 million from Central Hudson Gas & Electric Corporation, Consolidated Edison Company of New York, Inc. and Niagara Mohawk Power Corporation.

In May 2001, we entered into an asset-backed sale-leaseback transaction relating to these facilities to provide us with long-term financing for our acquisition. In this transaction, which was structured as a sale-leaseback to maximize the value of the facilities and to transfer ownership to the purchaser, we sold for approximately \$920 million four of the six generating units comprising these facilities to Danskammer OL LLC and Roseton OL LLC, each of which was newly formed by an unrelated third-party investor, and we concurrently agreed to lease them back from these entities, which we refer to as the owner lessors. The owner lessors used \$138 million in equity funding from the unrelated third-party investor to fund a portion of the purchase of the respective facilities. The remaining \$800.4 million of the purchase price and the related transaction expenses was derived from proceeds obtained in a private offering of pass-through trust certificates issued by two of our subsidiaries, Dynegy Danskammer, L.L.C. and Dynegy Roseton, L.L.C., who serve as lessees of the applicable facilities. The pass-through trust certificate structure was employed, as it has been in similar financings historically executed in the airline and energy industries, to optimize the cost of financing the assets and to facilitate a capital markets offering of sufficient size to enable the purchase of the lessor notes from the owner lessors. The pass-through trust certificates were sold to qualified institutional buyers in a private offering and the proceeds were used to purchase debt instruments, referred to as lessor notes, from the owner lessors. The lease payments on the facilities support the principal and interest payments on the pass-through trust certificates, which are ultimately secured by a mortgage on the underlying facilities.

As of December 31, 2003, future lease payments are \$60 million for each year 2004 through 2006, with \$1.3 billion in the aggregate due from 2007 through lease expiration. The Roseton lease expires on February 8, 2035 and the Danskammer lease expires on May 8, 2031. We have no option to purchase the leased facilities at the end of their respective lease terms. DHI has guaranteed the lessees' payment and performance obligations under their respective leases on a senior unsecured basis. At December 31, 2003, the present value (discounted at 10%) of future lease payments was \$758 million.

The following table sets forth our lease expenses and lease payments relating to these facilities for the periods presented.

	2003	2002	2001
	(in millions)		
Lease Expense	\$ 50	\$ 50	\$ 34
Lease Payments (Cash Flows)	\$ 60	\$ 60	\$ 30

If one or more of the leases were to be terminated because of an event of loss, because it had become illegal for the applicable lessee to comply with the lease or because a change in law had made the facility economically or technologically obsolete, DHI would be required to make a termination payment in an amount sufficient to redeem the pass through trust certificates related to the unit or facility for which the lease was terminated at par plus accrued and unpaid interest. As of December 31, 2003, the termination payment at par would be \$997 million for all of the DNE facilities, which exceeds the \$920 million we received on the sale of the facilities. If a termination of this type were to occur with respect to all of the DNE facilities, it would be difficult for DHI to raise sufficient funds to make this termination payment. Alternatively, if one or more of the leases were to be terminated because we determine, for reasons other than as a result of a change in law, that it has become economically or technologically obsolete or that it is no longer useful to our business, DHI must redeem the related pass through trust certificates at par plus a make-whole premium in an amount equal to the discounted present value of the principal and interest payments still owing on the certificates being redeemed less the unpaid principal amount of such certificates at the time of redemption. For this purpose, the discounted present value would be calculated using a discount rate equal to the yield-to-maturity on the most comparable U.S. treasury security plus 50 basis points.

Table of ContentsIndex to Financial Statements**Capital Expenditures**

In connection with our restructuring, we have undertaken various efforts to tightly manage costs and capital expenditures. We had approximately \$333 million in capital expenditures during 2003. This is a significant reduction from the approximately \$947 million in capital expenditures during 2002 and reflects our efforts to improve our capital efficiency without compromising the operational integrity of our facilities. Our 2003 capital spending by segment was as follows (in millions):

GEN	\$151
NGL	51
REG	126
Other	5
	<hr/>
Total	\$333
	<hr/>

Capital spending in our GEN segment primarily consisted of maintenance capital projects, as well as approximately \$40 million spent on completing the construction of the Rolling Hills facility, which began commercial operation during the summer of 2003. Capital spending in our NGL segment primarily related to maintenance capital projects and wellconnects, as well as \$8 million in development capital at our Cedar Bayou Fractionators, LP. Capital spending in our REG segment primarily related to projects intended to maintain system reliability and new business services.

We expect capital expenditures for 2004 to approximate \$375 million. This primarily includes maintenance capital projects, environmental projects, contributions to equity investments and limited GEN and NGL development projects. The capital budget is subject to revision as opportunities arise or circumstances change. Estimated funds budgeted for the aforementioned items by segment in 2004 are as follows (in millions):

GEN	\$150
NGL	75
REG	140
Other	10
	<hr/>
Total	\$375
	<hr/>

Increased capital spending in the NGL segment is primarily due to \$20 million for gathering system expansion, additional compression and plant de-bottlenecking in North Texas related to increased gas from the Barnett Shale formation and \$7 million for a significant upgrade in compression technology and efficiencies at our Monument gas processing plant.

As reflected in this section, the capital spending in our NGL segment includes 100% of the expenditures of our consolidated partnerships, Versado Gas Processors, LLC and Cedar Bayou Fractionators, LP. Our ownership percentages of these partnerships are 63% and 88%, respectively, and net funding equal to our ownership percentage is achieved through adjustments to partnership distributions. Adjusted for our partners' share of capital expenditures, our expenditures would have been \$45 million in 2003 and are expected to be \$67 million in 2004.

Our capital expenditures in 2004 and beyond will be limited by negative covenants contained in our restructured credit agreements. These covenants place specific dollar limitations on our ability to incur capital expenditures except in our REG segment. Please read Note 11—Refinancing and Restructuring Transactions beginning on page F-34 for further discussion of these transactions.

Table of Contents**Index to Financial Statements****Financing Trigger Events**

Our debt instruments and other financial obligations include provisions, which, if not met, could require early payment, additional collateral support or similar actions. These trigger events include leverage ratios and other financial covenants, insolvency events, defaults on scheduled principal or interest payments, changes in law resulting in loss of tax-exempt status on certain bond issuances, acceleration of other financial obligations and change of control provisions. We do not have any trigger events tied to specified credit ratings or stock price in our debt instruments and have not executed any transactions that require us to issue equity based on credit ratings or other trigger events.

Commitments and Contingencies

Please read Note 17—Commitments and Contingencies beginning on page F-51, which is incorporated herein by reference, for a discussion of our commitments and contingencies.

Dividends on Preferred and Common Stock

Dividend payments on our common stock are at the discretion of our Board of Directors. We do not foresee a declaration of dividends in the near term, particularly given the dividend restrictions contained in our financing agreements. We have, however, continued to make the required dividend payments on our outstanding trust preferred securities. Please read Note 11—Refinancing and Restructuring Transactions beginning on page F-34 for a discussion of the dividend restrictions contained in our financing agreements.

The Series B Preferred Stock issued to ChevronTexaco in November 2001 had no dividend requirement. Because of ChevronTexaco's discounted conversion option, however, we accreted an implied preferred stock dividend over the redemption period, as required by GAAP. Please read Note 15—Redeemable Preferred Securities beginning on page F-48 for further discussion of this non-cash implied dividend. In conjunction with the Series B Exchange, we recognized a gain of approximately \$1.2 billion as a preferred stock dividend during 2003.

We accrue dividends on our Series C preferred stock at a rate of 5.5% per annum. We accrued \$8 million in dividends during the year ended December 31, 2003. We did not make any dividend payments on the Series C preferred stock during the year ended December 31, 2003. However, we made the first semi-annual dividend payment of \$11 million on February 11, 2004, as a result of which capacity under our revolving credit facility was reduced by \$11 million. Dividends are payable on the Series C preferred stock in February and August of each year, but we may defer payments for up to 10 consecutive semi-annual periods. Please read Note 15—Redeemable Preferred Securities beginning on page F-48 for further discussion.

Internal Liquidity Sources

Our primary internal liquidity sources are cash flows from operations, cash on hand and available capacity under our \$1.1 billion revolving credit facility, which is scheduled to mature on February 15, 2005.

Cash Flows from Operations. We had operating cash flows of \$876 million in 2003, which included approximately \$500 million associated with our CRM business and \$110 million from a federal income tax refund, neither of which is expected to be repeated in 2004. For 2004, we have projected operating cash flows of \$150 to \$185 million. This projection, which is subject to change based on a number of factors, many of which are beyond our control, reflects \$825 to \$850 million in forecasted operating cash flows from our GEN, NGL and REG business segments, offset by projected cash outflows of \$180 to \$185 million from our customer risk management business and \$485 to \$490 million in corporate-level expenses, including interest.

Our operating cash flows are significantly impacted by commodity prices, particularly in our power generation and NGL businesses. Although the depressed frac spread is negatively impacting our NGL segment's